NFAC 7715-81
27 November 1981

MEMORANDUM FOR: Chairman, National Intelligence Council

FROM : [redacted] STAT
Senior Review Panel

SUBJECT : [redacted] Paper on Industrial Policy STAT

1. I have read the reference paper with interest, but was somewhat hampered by not having copies of the Exhibits. Do you have a set? (I also wish that the Xerox had done a better job on your handwritten notes.)

2. It seems to me that [redacted] may be on a track toward something of consequence, and in any event is addressing some good questions in his comparative and historical analyses. He evidently possesses a lively mind. But I am also troubled by the superficiality of some of the analysis, by internal inconsistencies on some points, and by the vagueness of the kind of prescription he appears to have in mind in the concluding pages. Examples follow. STAT

3. In the diagnosis, he has many passages which accept the current faddism which treats all government activity as non-productive and all private activity as productive; which sharply separates policies into production-promoting and consumption-promoting; and which attributes industrial country stagflation to excessive post-war welfarism. Contrary to his statement on page 2, many economic and social programs of the last half century have contributed positively to productivity: notably those expanding education at all levels, supporting R & D, and promoting health--but also including a lot of more traditional infrastructure works (interstate highways), agricultural extension, etc. A more discriminating treatment is needed.

4. More generally, he seems to accept a primitive form of linear correlation between capital formation and productivity or growth rates. I explored that matter in some detail in a paper for the International Chamber of Commerce meeting at Stockholm in 1976. A copy is attached (need not be returned). Note especially pages 8-12 of the text, and the Figures referred to in those pages. As the Denison and Kuznets studies have made clear, the relationship is much more complex, and factors

other than capital inputs, as well as efficient or inefficient uses of capital, make more difference to growth rates than the mere quantity of savings and investment.

5. One might conclude from much of his argumentation that the indicated recipe for high growth would be a return to the policies of the 1920s or perhaps even the 1880s. It is only on page 20 that he acknowledges that growth rates in the industrial world in the quarter century 1948-73 were higher than at any previous time in history, notwithstanding the large amount of welfarism and governmental interventionism of that era. Evidently something happened around 1973 (many people would say the OPEC price increases) that created a discontinuity, but it was not a sudden onset of welfare and other anti-work policies. I am not sure that anyone has yet identified the causes with confidence.

6. In the first discussion of industrial policies (pp.6-14), Scott seems to favor "promoting winners," but he regards all kinds of investment planning or selective policies as inherently bad. Yet the identification of potential "winners" is itself a kind of selective policy.

7. The analogizing between business and national decision-making is seductive but potentially misleading. There are many more basic differences between business and national planning than the fact (p. 12) that one is done in private and the other in public.

8. Like you, I am bothered by counting transfer payments in government expenditures when they are calculated as a proportion of GNP (p. 17); that includes them in the numerator but not the demoninator, and thereby greatly overstates their relative size.

9. [redacted] seems to be greatly concerned about the decline STAT
of the share of manufacturing in GNP in the most advanced countries. Up to a considerable point, that scarcely seems more consequential than the previous decline in shares of agriculture and primary materials. It is a natural consequence of the structural changes that constitute development, including the increase in the proportion of services in both final and intermediate demand. (On these very long-run issues, you may want to look at the second attached paper, done for the Woodlands Growth Conference in 1979.)

10. Some of the newly industrializing countries have not been as unalloyed successes as he suggests. Assuming that Brazil and Mexico are in that category, the statement at the top of page 22 about maintaining full employment is very far indeed from the facts.

11. On the basic point that a productivity-stimulating policy largely limited to helping the rich and depending on trickle-down will not fare well in democratic societies, he is surely right. After all, the richer a society the more likely that voters will be as concerned with equality of opportunity and limits to inequality of incomes as they will with overall national growth rates. Therefore some way of dissolving class conflict--whether by co-determination or profit-sharing or "people's capitalism" or some other means--seems indispensable. That is what [redacted] is hinting at in his final section. But it is by no means clear that the best way to do it is enterprise-by-enterprise; on the contrary, that might ensure a national policy of succoring Chryslers, Leylands, etc. STAT

12. Notwithstanding the critical character of these quick reactions, I should like to meet Scott and join in any exploration with him of ways in which cross-country analyses might help identify critical issues of competitive policy.

[redacted] STAT

Attachments

cc: NIO/Economics (w/o atts)

SRP:[redacted] (27 Nov 81) STAT
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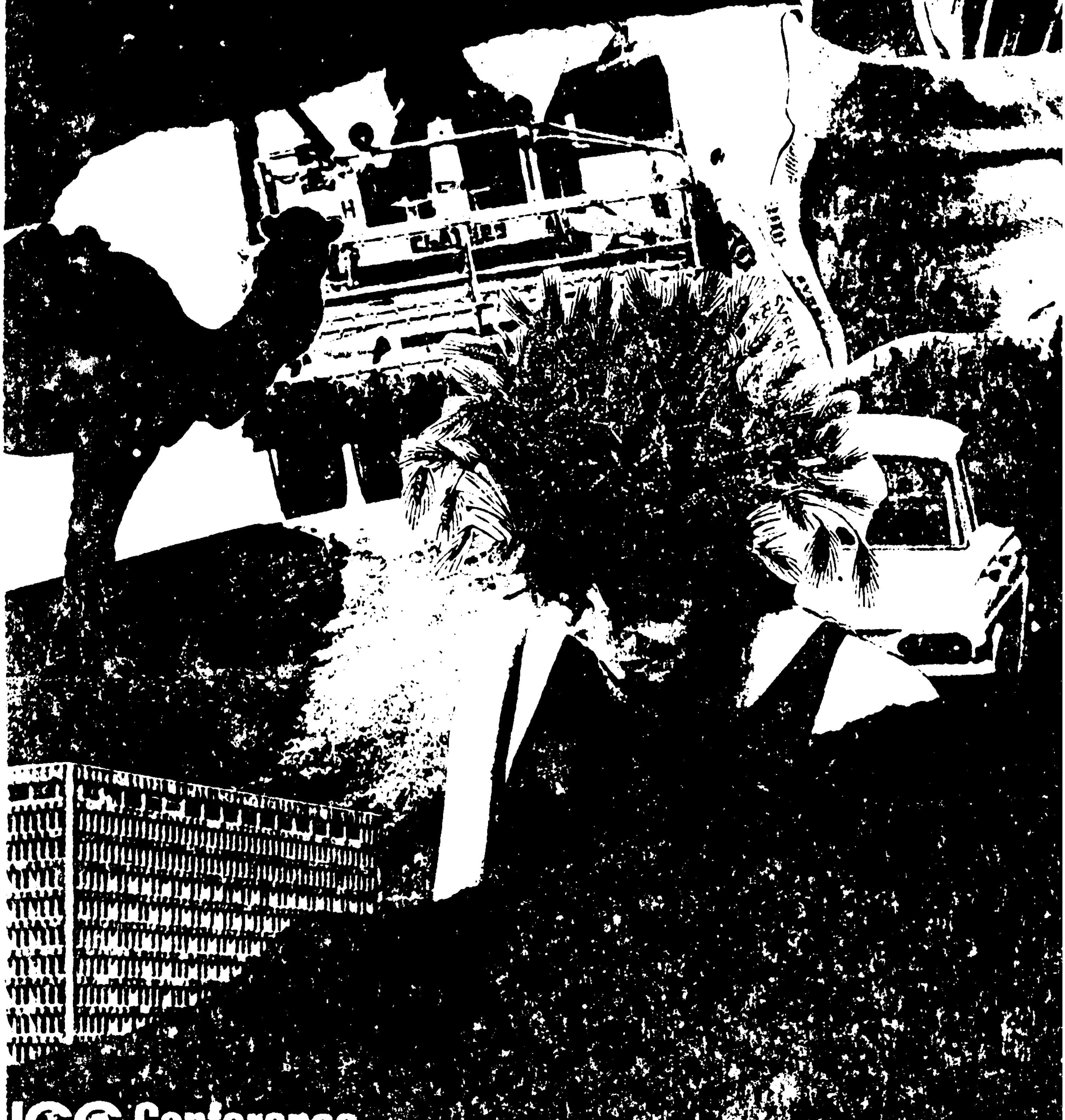
The conditions for investment in countries at different levels of development

Lincoln Gordon (United States)



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Statistical background

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PERGAMON POLICY STUDIES ON BUSINESS AND ECONOMICS

The Management of Sustainable Growth

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